DIRECT TESTIMONY OF

SCOTT D. WILSON

ON BEHALF OF

SOUTH CAROLINA ELECTRIC & GAS COMPANY

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Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Scott D. Wilson and my address is 6400 Jamaica Court, Tallahassee, FL 32309.

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A. I am the founder and principal of the Wilson Consulting Group, a consulting firm specializing in providing financial, regulatory and accounting consulting services to the electric utility industry.

Q. DESCRIBE YOUR EDUCATIONAL BACKGROUND AND BUSINESS EXPERIENCE.

A. I hold a Bachelor of Science degree in Accounting from Florida State University. I am a Certified Public Accountant and a member of the American Institute of Certified Public Accountants. After graduation, I worked as a staff auditor with Arthur Andersen & Co. from 1977-1979. From 1979-1984, I was a member of the staff of the Florida Public Service

Commission, where I ultimately served as the Director of the Audit and Financial Analysis section. From 1985-1987, I served clients in the utility industry as a Senior Manager in Ernst & Whinney's National Utility Group, where my areas of responsibility included regulatory policy and rate case support, regulatory economics, and participation in management audits. I left Ernst in 1987 to serve as Director of Financial Consulting for Energy Management Associates until 1989, during which time I was responsible for merger and acquisition analysis, regulatory policy and rate case support, and regulatory economic analyses. From 1989-1991, I served as the Senior Corporate Financial Analyst for Citibank's Southeast region, where I was responsible for managing and directing Citibank's corporate finance analyses for both non-regulated and regulated businesses regarding potential corporate finance business opportunities. I worked with Scott, Madden & Associates, Inc. from 1991-1992 as a Director in its Management Consulting Practice emphasizing regulatory policy and case support, strategic planning, and financial forecasting and planning. I left Scott, Madden in 1992 to start Wilson Consulting Group, a consulting firm specializing in providing financial, regulatory and accounting consulting services to the electric utility industry. In 2003, I concluded the operations of the Wilson Consulting Group and joined El Paso Electric, where I held the position of Vice President of Corporate Planning and Controller before becoming Executive Vice President, Chief Financial Officer, and Chief

Administrative Officer in May 2005. I retired from El Paso Electric in May 2009 and restarted the Wilson Consulting Group.

Q. HAVE YOU PREVIOUSLY PRESENTED TESTIMONY BEFORE UTILITY REGULATORY COMMISSIONS?

A. Yes. I have testified before the Arizona, Florida, New Mexico, Ohio and Texas Commissions.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. The purpose of my testimony is to present my independent assessment of SCE&G's proposal to recover an incentive associated with its costs of implementing its demand-side management ("DSM") programs. This incentive would be recovered via an adder to the rate of return applicable to SCE&G's DSM programs, which is a mechanism providing for application of an enhanced return on equity ("ROE") to SCE&G's investment costs in DSM programs. I also provide my opinion regarding the reasonableness both of SCE&G's rate of return incentive proposal and the ROE "adder" of 3%.

Q. WHAT IS A DEMAND-SIDE MANAGEMENT PROGRAM?

A. As this Commission is aware and as others have testified, an effective DSM program is designed to reduce demand and energy consumption by utility customers. However, in order to encourage a utility's investment in DSM measures, a proper DSM recovery mechanism, among other things, must provide sufficient revenue to allow the utility to maintain earnings at least equal to its earnings prior to implementation of DSM programs, while also providing additional support for achieving the public policy goal of utility investment in cost-effective DSM programs.

Q. WHY IS IT NECESSARY TO AFFORD AN ELECTRIC UTILITY AN INCENTIVE TO INVEST IN DSM PROGRAMS?

A. Under traditional rate-of-return ratemaking, an electric utility's earnings are a function of the amount of capital invested in its rate base, which most commonly includes generation, transmission, distribution and general plant in service. An effective DSM program will reduce the amount of energy purchased and capacity demanded by consumers and, concomitantly, will increase the amount of capital invested by the electric utility in DSM programs and decrease the amount of capital invested in generation and distribution equipment. Without an appropriate recovery mechanism, the reduction in demand and energy purchased by consumers and the reduction in the utility's revenues will reduce earnings. As Section 58-37-20 reflects, providing the utility with a reasonable incentive for DSM investment is necessary and helpful in supporting ongoing investment in DSM programs.

Q. DOES THE IMPLEMENTATION OF AN EFFECTIVE DSM PROGRAM HAVE AN IMPACT ON AN ELECTRIC UTILITY'S COST OF CAPITAL?

A. Yes. In the absence of an effective cost-recovery mechanism like that contemplated by the South Carolina General Assembly, investors in the electric utility will perceive the potential impacts of an effective DSM program as increasing both the near-term and long-term incremental risks of an investment in the utility. If those incremental risks are not offset, at a minimum, by a provision establishing financial equivalence, in terms of costs and margin recovery, between these demand-side investments versus more traditional supply-side capital expenditures, investment in the utility will become less attractive and the Company's access and cost of funds could be adversely impacted.

Q. PLEASE IDENTIFY THE POTENTIAL NEAR-TERM AND LONG-TERM IMPACTS ON UTILITY INVESTORS THAT ARISE FROM IMPLEMENTING DSM PROGRAMS.

A. The near-term and long-term impacts on utility investors from implementation of an effective DSM program include the potential reduction in both fixed cost recovery and net income due to lost revenues; uncertainty regarding the recovery of DSM program cost; and the size and ultimate recoverability of any regulatory asset account pertaining to a DSM program. The long-term impact of an effective DSM program also includes, as I referenced above, a potential reduction in the electric utility's investment in traditional capital assets, which reduces the future earnings capacity of the utility.

Q. PLEASE EXPLAIN THE IMPACT THAT A REDUCTION IN FIXED COST RECOVERY AND NET INCOME HAS ON INVESTORS.

A. An effective DSM program will reduce kilowatt-hour ("kWh") sales. This sales reduction leads to a reduction in the utility's net income, and hence the inability of the utility to recover its full cost of providing service to its customers. Though reduced kWh sales could be recognized after the fact in a subsequent rate case, the utility would be unable to recover its full cost of service between rate cases. To the extent new and improved DSM programs were continually being rolled out, the utility would be in a constant state of under-recovering its costs of providing service. Prolonged cost under-recovery will lead to higher costs of capital and inferior access to capital markets. Consequently, a mechanism that properly allows for the timely recovery of lost net revenues is a key part of implementing a DSM program.

Q. PLEASE EXPLAIN THE IMPACT ON INVESTORS OF UNCERTAINTY SURRROUNDING PROGRAM EXPENSE

RECOVERY AND THE SIZE AND RECOVERABILITY OF ANY DSM-RELATED REGULATORY ASSET.

A. Investors will also perceive increased investment risk should there be uncertainty regarding the full and timely recovery of all DSM-related expenses and uncertainty regarding the return actually earned on the unrecovered balance in any DSM deferred cost account. In finance, risk is usually thought of in terms of volatility of expected returns–the more volatile an income stream, the greater risk attributed to that stream. Therefore to the extent volatility can be minimized, all other things being equal, risk and consequently the cost of capital can be mitigated. Therefore, removing uncertainty surrounding DSM program cost recovery and the recovery of the appropriate return on any capitalized (deferred) DSM program costs will serve to mitigate risk and therefore mitigate the cost of capital for SCE&G relative to its implementation of a DSM program.

Q. COULD THE SIZE OF THE DEFERRED ASSET ACCOUNT (REGULATORY ASSET) THAT SCE&G PROPOSES TO USE AS PART OF IMPLEMENTING DSM PROGRAMS BE PROBLEMATIC FROM A FINANCIAL PERSPECTIVE?

A. Should the regulatory asset account on the balance sheet become too large, it may become a concern to rating agencies and adversely impact bond ratings, which constitute an additional risk to investors, especially to bond investors, who are seeking relatively safer returns than equity investors. However, as more fully testified by Company Witness Kenneth R. Jackson, the Company proposes to partially mitigate this risk by providing for a five-year amortization.

Q. HAS THE SOUTH CAROLINA GENERAL ASSEMBLY ENACTED STATUTORY AUTHORIZATION FOR A DSM PROGRAM THAT INCLUDES INCENTIVES TO OFFSET THE INCREMENTAL INVESTMENT RISKS THAT YOU DESCRIBE?

A. Yes. As Company Witness Jackson has testified, the South Carolina General Assembly has enacted Section 58-37-20, which requires that any Commission program encouraging electric utilities like SCE&G to "invest in cost-effective energy efficient technologies and energy conservation programs" also include the following:

- provide incentives and cost recovery for electric utilities that invest in "energy supply and end-use technologies that are cost-effective, environmentally acceptable, and reduce energy consumption or demand";
- allow electric utilities making these investments "to recover costs and obtain a reasonable rate of return on their investment in qualified demand-side management programs sufficient to make these

programs at least as financially attractive as construction of new generating facilities"; and

- require the Commission "to establish rates and charges that ensure that the net income" of an electric utility "after implementation of specific cost-effective energy conservation measures is at least as high as the net income would have been if the energy conservation measures had not been implemented."

A proper implementation of these provisions will allow SCE&G to maintain its financial position and continue to attract equity and debt capital on reasonable terms while implementing DSM programs that reduce energy sales and demand.

Q. ARE YOU FAMILIAR WITH THE DSM PROGRAMS PROPOSED BY SCE&G?

A. Yes, I am.

Q. WHAT INCENTIVE DOES SCE&G PROPOSE AS PART OF ITS DSM PROGRAMS?

A. SCE&G proposes that it be allowed to recover an additional or incremental return of 3%—typically called an "adder"—on its DSM program investments in addition to its currently approved ROE of 11%, which was established in Commission Order 2007-855. One impact to an electric utility from implementation of an effective DSM program is a reduction in its need to invest in traditional electric utility assets, which are the source of its return under traditional rate-making procedures like those employed by SCE&G. Investors may be concerned about this impact because, overall, investors favor larger revenue streams backed by hard assets compared to smaller revenue streams backed by regulatory assets. However, an incentive added to the common equity return can partially mitigate the Company's lost revenue stream from foregone investment while also providing an incentive for the Company to pursue aggressively DSM programs. Therefore, in my opinion, an adequate ROE adder will enable the Company to continue to attract and maintain capital at reasonable rates to support both DSM programs and its traditional utility services, and will encourage the Company to invest prudently in its DSM programs.

Q. IS IT YOUR OPINION THAT THE 3% ADDER PROPOSED BY SCE&G IS REASONABLE AND ADEQUATE?

A. Yes. I believe this 3% adder to be a reasonable incentive to compensate SCE&G and its investors for the additional perceived risk of investing in DSM programs rather than fixed generation assets and in accepting a lower revenue stream based on the revenue reduction caused by an effective DSM program. I also believe that SCE&G's proposal to add

3% to the aforementioned ROE of 11% provides a reasonable incentive to SCE&G to aggressively invest in cost-effective DSM programs. To produce the desired energy-efficient results, the incentive mechanism must induce the desired results by providing the utility with an incentive to make investments in energy-efficient programs. Several states have either or both enabling legislation and Commission orders allowing ROE adders for DSM programs. The ROE adders have ranged as high as 5%. The Company's requested 3% adder is below the upper range of incentive adders authorized in other jurisdictions, serves reasonably to encourage the Company to make DSM investments, and avoids penalizing the Company for making such investments, consistent with South Carolina law.

Q. WHY DOES SCE&G PROPOSE TO USE AN EQUITY ADDER THAT WILL BE APPLIED TO THE BALANCE IN THE DSM ACCOUNT?

A. There are several ways to provide a financial incentive to SCE&G for investing in cost-effective DSM programs. These alternatives include (1) SCE&G's ROE adder; (2) additional recovery of a percentage of allowable DSM program costs; and (3) retention of a portion of the net benefits from investing in DSM. In my opinion, SCE&G's proposal is reasonable and should be implemented in this case.

Q. WHY IS SCE&G'S PROPOSAL TO USE AN ROE ADDER REASONABLE AND PREFERABLE IN THIS CASE?

A. In my opinion, the real strength of SCE&G's incentive proposal is that it is fair, transparent, easily understood, and consistent with South Carolina Code Section 58-37-20. This would distinguish it from shared savings proposals, in which the calculation of benefits is subject to disagreement and dispute. By contrast, the ROE adder proposed by SCE&G is visible, easy to calculate and easy to monitor for all the parties involved in the regulatory process. Investors will be more comfortable with investing in a utility employing this process because they can easily identify the impact from DSM investments and, thus, determine the impact that DSM programs have on their investments in the Company.

Q. PLEASE SUMMARIZE YOUR TESTIMONY.

A. It is my opinion that SCE&G's proposal to recover a 3% adder in addition to the approved common equity return on the outstanding balance of the DSM account is a reasonable incentive for investing in cost-effective DSM programs and is consistent with financial theory and regulatory practice. This incentive mechanism will also enable SCE&G to continue to attract and maintain capital at reasonable rates to support DSM programs as well as its traditional utility service.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.